

**RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL**

**MUNICIPAL YEAR 2016-2017**

**COMMITTEE:  
FINANCE AND PERFORMANCE  
SCRUTINY COMMITTEE**

<b>PART 1</b>	<b>AGENDA ITEM NO. 4</b>
<b>TREASURY MANAGEMENT STRATEGY INCORPORATING INVESTMENT STRATEGY, PRUDENTIAL INDICATORS AND MRP STATEMENT for 2017/18</b>	

**4<sup>th</sup> April 2017**

**REPORT OF :**

**THE GROUP DIRECTOR, CORPORATE AND FRONTLINE SERVICES**

**Chris Lee (01443) 424026**

**1.0 PURPOSE OF REPORT**

1.1 This report constitutes the requirement to provide Members with the opportunity to scrutinise the Treasury Management Strategy approved by Council on 15<sup>th</sup> March 2017. The Council report is attached at Appendix 1 and details:

- Treasury Management Strategy for 2017/18;
- Investment Strategy for 2017/18;
- Prudential and Treasury Indicators for 2016/17 (actuals to date) and 2017/18, 2018/19 and 2019/20; and
- the Minimum Revenue Provision (MRP) Policy Statement.

**2.0 RECOMMENDATIONS**

It is recommended that Members:

- 2.1 Scrutinise and comment on the information provided.
- 2.2 Consider whether they wish to scrutinise in any greater depth, any matters contained in the report.

**3.0 CONCLUSION**

- 3.1 This report, together with Appendix 1 provides Members with the opportunity to scrutinise the Treasury Management Strategy for 2017/18.

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**RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL**

**MUNICIPAL YEAR 2016-2017**

**COUNCIL**

**15th March 2017**

***Item No:8***

**TREASURY MANAGEMENT STRATEGY  
INCORPORATING INVESTMENT  
STRATEGY, PRUDENTIAL INDICATORS  
and MRP STATEMENT for 2017/18**

**REPORT OF THE GROUP DIRECTOR CORPORATE AND FRONTLINE  
SERVICES**

**AUTHOR:- CHRIS LEE (01443) 424026**

**1.0 PURPOSE OF THE REPORT**

- 1.1 The purpose of the report is to set out the Council's:-
- Treasury Management Strategy for 2017/18;
  - Investment Strategy for 2017/18;
  - Prudential and Treasury Indicators for 2016/17 (actuals to date) and 2017/18, 2018/19 and 2019/20; and
  - Minimum Revenue Provision (MRP) Policy Statement.

**2.0 RECOMMENDATIONS**

It is recommended that Members:

- 2.1 Approve the Treasury Management Strategy, Investment Strategy, Prudential and Treasury Indicators as set out in the report;
- 2.2 Grant the Section 151 Officer (or in his absence the Deputy Section 151 Officer) with delegated powers to exceed the fixed / variable limits, in the best financial interests of the Authority only, and if utilised, that this be reported to the next available meeting of Council (paragraph 18.6 of the report refers).

**3.0 INTRODUCTION**

- 3.1 CIPFA defines Treasury Management as:  
*"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective*

*control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”*

- 3.2 The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Treasury Management Code of Practice and the CIPFA Prudential Code. This report also meets the requirements of Welsh Government MRP Guidance and Welsh Government Investment Guidance.
- 3.3 This Treasury Management Strategy Statement details the expected activities of the Treasury Management function in the forthcoming financial year (2017/18). Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management, as adopted by the Council on 6<sup>th</sup> March 2002. The 2001 Code was fully revised in 2009 with minor updates in 2011. Adoption of the Code is one of the Prudential Indicators and we comply in this respect.
- 3.4 To supplement the CIPFA Code of Practice, the Welsh Government has issued Guidance on Local Government Investments which require local authorities to report their Investment Strategy. A key requirement of the guidance is to explain management of risk associated with Treasury Management activity. Reports on actual activity will be produced after the year end and also following a mid year review. Such reports, including this strategy are subject to Member scrutiny.
- 3.5 The Prudential Code came into effect from 2004/05 and was fully revised during 2009 with minor updates in 2011 and 2013. The Code is produced by the Chartered Institute of Public Finance and Accountancy (CIPFA) and is underpinned by the Local Government Act 2003 and the Capital Financing Regulations (Wales) 2004. The Code sets out a framework for self regulation of capital spending, in effect allowing Councils to invest in capital projects without any limit as long as they are affordable, prudent and sustainable.
- 3.6 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires revenue costs from capital financing decisions to be included in the budget requirement.

#### **4.0 TREASURY MANAGEMENT STRATEGY 2017/18**

- 4.1 The proposed Treasury Management Strategy for 2017/18 is based on officers' views on likely interest rates, supplemented with forecasts provided by the Council's independent treasury advisors. The strategy covers:
  - Current Portfolio Position
  - Prospects for Interest Rates
  - Borrowing Strategy (including borrowing in advance of need)
  - Debt Rescheduling Opportunities

- 4.2 Information is also provided on the use of Treasury Management advisors and the training that has taken place.

## 5.0 **Current Portfolio Position**

- 5.1 The Council's treasury portfolio position as at the end of January 2017 (Period 10) comprised:

		£M	Av. Rate
<b><u>Debt</u></b>			
Fixed Rate	PWLB	109.297	4.81%
	Market	56.500	5.16%
	Market(LOBO)	31.000	4.50%
Variable Rate	Market *	25.000	0.38%
		<b>221.797</b>	<b>4.36% **</b>
<b><u>Investments</u></b>			
Variable Rate	Public Bodies	Nil	n/a

\* Market debt with effect from 25<sup>th</sup> January 2017.

\*\* Weighted average rate of borrowing for 2016/17 is 4.76%.

- 5.2 As at the end of January the total investments at variable rate were nil as the Council had a short term borrowing requirement. Any investments as a result of surplus cashflow earned an average rate of 0.22% during the year to the end of January 2017.
- 5.3 In June 2016 Barclays Bank informed the Council of its decision to cancel all embedded options within their standard LOBO loans. Consequently, £54.5m has been classified as market fixed rate debt.
- 5.4 A LOBO is a financial instrument called a "Lender's Option Borrower's Option". It provides a lower rate of interest for the initial period and a higher rate for the rest of its term (reversionary period), albeit that the higher rate was comparable with interest rates prevailing at the time the loans were taken. At the end of the initial period and at six monthly intervals, the lender has the option to increase the interest rate payable. This provides the Council with the option to repay the loan if the terms are not acceptable.

## **6.0 Prospects for Interest Rates**

- 6.1 The level of the Bank Rate (set by the MPC – Monetary Policy Committee) tends to be the main factor which determines the rate of interest the Council receives on its short term investments. On 4<sup>th</sup> August 2016 the Bank of England cut its Official Bank Rate from 0.5% to 0.25%.
- 6.2 The forward looking estimate of the Bank Rate, as provided by our Treasury Management advisors is for the rate to remain at 0.25% throughout 2017/18 and into the foreseeable future, with a low possibility of a reduction to zero. These form the basis of our projections for interest receivable.
- 6.3 Generally, the Council borrows its long term funding from the Public Works Loans Board (PWLB). Long term PWLB rates increase and decrease in line with gilt yields (government bonds). The Council's Treasury Management advisors latest forecast of interest rates is as follows:

	<b>5 yr</b>	<b>10 yr</b>	<b>20 yr</b>	<b>50 yr</b>
2017/18	1.50%	1.95%	2.50%	2.40%
2018/19	1.60%	2.05%	2.60%	2.50%
2019/20	1.80%	2.25%	2.80%	2.70%

- 6.4 In the UK the Monetary Policy Committee has increased its estimate for growth in 2017, with expectations of a slowdown in this growth in 2018 and 2019. There is an expected rise in inflation, currently 1.8% (CPI, January 2017), which could reduce household spending growth, while economic and political uncertainty will dampen investment intentions.
- 6.5 The long term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- 6.6 Investment returns are likely to remain low during 2017/18. With short term interest rates currently much lower than long term rates, it is more cost effective to borrow short term. By doing so the Authority is able to reduce borrowing costs (despite foregone investment income) and reduce overall treasury risk.

## **7.0 Borrowing Strategy (including borrowing in advance of need)**

- 7.1 The Council's borrowing requirement for 2017/18 is currently £40.0m based on the current Capital Programme (as approved by Council, 1<sup>st</sup> March 2017). The opportunities afforded by the Prudential Code increase the possibility of further borrowing being required during the year. The strategy and Prudential Limits may need to be refined accordingly in light of future decisions. Further details of Prudential Indicators and limits are in the Prudential Indicator section of this report.

- 7.2 As Members are aware, the Council is part of the Cardiff Capital Region City Deal. The precise content and programme of City Deal projects is yet to be determined and therefore the Treasury Management implications for this Council and our involvement in capital delivery will be reported as this becomes clear.
- 7.3 Uncertainty over future interest rate prospects increases the risks associated with treasury activity. As a result the Council will continue to take a cautious approach to its treasury strategy.
- 7.4 The lowest cost borrowing will continue to be maximising “internal borrowing”, running down cash balances and foregoing interest earned at historically low rates. This also minimises counterparty risk (risk that an investment may become irrecoverable). This continues to be our favoured approach (referred to as maintaining an “underborrowed” position), meaning that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt.
- 7.5 Short Term borrowing could be taken from the money market or other public bodies such as local authorities.
- 7.6 For 2017/18 the Council may arrange forward starting loans where the interest rate is fixed in advance, but the cash is received at a later date, up to a maximum of one year. This would enable certainty of costs without suffering a cost of carry in the intervening period. The cost of carry is the cost incurred where funds are borrowed prior to being required.
- 7.7 Shorter term fixed rates may provide lower cost opportunities in the short/medium term. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to balancing the short term advantage of short term borrowing against potential long term costs if the opportunity is missed for taking loans at low longer term rates which are likely to be higher in future years.
- 7.8 There are uncertainties associated with the forecasts detailed above. Alternative approaches given different interest rate forecasts are shown below:
- Risk of sharp fall in long and short term rates – long term borrowing will be postponed and potential rescheduling from long term to short term borrowing could be considered.
  - Risk of sharper than forecast rise in long and short term rates – fixed rate borrowing taken whilst rates still cheap.
- 7.9 The Group Director, Corporate and Frontline Services, as Section 151 Officer (or in his absence the Deputy Section 151 Officer), under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates and forecasts at the time, taking into account advice provided by our advisors and an assessment of risk. Members will be advised of borrowing activity during the year as part of the Council's

quarterly performance reporting arrangements and the Treasury Management mid year review.

- 7.10 The revised Codes of Practice require Councils to specify their approach in terms of “Borrowing in Advance of Need”. In line with the Prudential Code, Councils are able to borrow funds above their Capital Financing Requirement (ie its underlying borrowing requirement) for use in future years, thereby providing a degree of flexibility in terms of timing during the most favourable interest rate conditions. This Council's levels of debt have been and remain significantly lower than our CFR (see Prudential Code section) and it is not anticipated that borrowing in advance of need is a course of action that this Council would pursue in the short to medium term. Consequently, there is no need to set a limit in terms of value or period of time. Risks and opportunities associated with borrowing in advance of need will continue to be monitored during the year and reported in the mid year review of treasury management activities.

## **8.0 Debt Rescheduling Opportunities**

- 8.1 Debt rescheduling refers to the premature repayment of existing debt and replacing it with alternative cheaper borrowing.
- 8.2 The introduction by the PWLB in 2007 of a difference in rates applied to new borrowing and repayment of existing debt has been compounded since October 2010 by a further widening of the difference between new borrowing and repayment rates. This has meant that PWLB rescheduling is now less attractive. Consideration would have to be given to the large premiums which would be incurred on repaying debt early.
- 8.3 As short term borrowing rates are forecast to be considerably cheaper than long term rates, there may be potential to switch from long to short term debt. However, these savings will need to be considered in light of the premiums incurred, the short term nature of the savings, and the likely cost of refinancing those short term loans once they mature.
- 8.4 Early repayment of debt could also be considered. This would run down investment balances as short term rates on investments are likely to be lower than that on debt. However, premium costs may be expensive and our investment balance estimates for 2017/18 are relatively low, therefore such a course of action is unlikely to be viable.
- 8.5 Any rescheduling and repayment of debt is likely to impact upon the Council's debt maturity profile and this will need to be considered in accordance with the relevant indicator.
- 8.6 The Council has previously taken advantage of maximising debt rescheduling opportunities. The reasons for any rescheduling to take place could include:
- the generation of savings, at minimum risk;
  - to help fulfil the strategy outlined in section 7 above; or



- to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

8.7 The Group Director Corporate and Frontline Services will monitor prevailing rates for any opportunities during the year based upon information provided by the Council's Treasury advisors.

## **9.0 Treasury Management Advisors**

9.1 The Council's Treasury Management advisors are Arlingclose Ltd. The company provides a range of services including:

- Technical support on treasury matters, capital finance issues and suggested report formats;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice on the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies.

9.2 Whilst the advisors provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on any treasury matter remains with the Council.

9.3 The Council ensures that quality of service is maintained via feedback at regular meetings with key contacts.

9.4 In line with contractual arrangements and following a review of the service received, the Council has taken the option to extend the contract for a further 2 years (to 31<sup>st</sup> March 2019).

## **10.0 Member and Officer Training**

10.1 During 2016/17, officers within the Treasury Management section have attended seminars facilitated by our advisors.

10.2 As part of continued professional development, officers will continue to keep up to date with emerging issues via seminars, research and regular information provided by advisors and other sources.

10.3 A training session was held for Members during October 2016. This was facilitated by our advisors. If any emerging issues arise, specific training sessions can be arranged.

10.4 The Councils Senior Accountant, Pension Fund and Treasury Management holds the Certificate in International Treasury Management – Public Finance, a professional qualification of CIPFA and the Association

of Corporate Treasurers in the fundamentals of treasury management for the public service.

## **11.0 Reporting and Scrutiny**

11.1 The Finance and Performance Scrutiny Committee will continue to undertake the required scrutiny function for treasury management activities. This will include:

- Quarterly updates (as part of the Council's Performance Reporting arrangements)
- Strategy report (as reported to full Council)
- Formal mid year review of treasury management (as reported to full Council)
- Annual review (as reported to full Council).

## **12.0 INVESTMENT STRATEGY**

12.1 The Council's investment strategy has regard to the Welsh Government's Guidance on Local Government Investments and the 2013 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities will be security first, liquidity second and then yield (return).

12.2 The key requirements of both the Code and the investment guidance (issued by the Welsh Government) are to set an investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- Specified investments the Council will use together with the minimum acceptable credit quality. These are high security (i.e. high credit quality, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.
- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.

12.3 The intention of the strategy is to provide security of investment and minimisation of risk.

### **12.4 Specified Investments**

An investment is a Specified Investment if all of the following apply:

1. the investment is denominated in sterling
  2. it is not long term
  3. it is not defined as capital expenditure
  4. it is of high credit quality or with one of the following public sector bodies:
    - a. the UK government; or
    - b. a local authority in England or Wales (as defined in S23 of the 2003 Act) or similar body in Scotland or Northern Ireland
- 12.5 These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:
- The UK Government (such as the Debt Management Account Deposit Facility, UK Treasury Bills or a Gilt with less than one year to maturity).
  - Supranational bonds of less than one year's duration.
  - A local authority, parish council or community council.
  - A body that is considered of a high credit quality. This covers bodies with a minimum long term rating of A- (or the equivalent) as rated by Fitch rating agency or equivalent.
  - Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies.
- 12.6 The Code of Practice requires Councils to not rely solely on credit ratings but to supplement it with other information. The other information referred to includes quality financial press, credit default swaps, share prices, annual reports, statements to markets, information on government support for banks, credit ratings of that government support, rates being paid, what other banks are saying, information provided by advisors, market price (and movement of market price) of existing debt securities issued by counterparties. This represents a significant pool of "other information".
- 12.7 The review of all such information will be incorporated into the Council's decision making processes although it will not be a simplistic and quick process and will need to be considered alongside the relative benefits of making one investment over another (e.g. versus DMO) and the relative risks of exposing the Council's resources.
- 12.8 Members will recall that all of the Council's investments were transferred to the Debt Management Office DMADF (Debt Management Account Deposit Facility) upon the onset of the national and international economic crisis which started in 2008. The cost of this security in terms of loss of interest is negligible as rates offered by banks for short term deposits are comparable to rates offered by the DMO DMADF and other public bodies.

- 12.9 It is proposed that these arrangements continue for 2017/18, that is, that all council investments will be with the DMADF or with other Government backed Public Sector Bodies, and that these arrangements should be kept under constant review.

## **12.10 Non-Specified Investments**

- 12.11 Non-specified investments are any other type of investment (i.e. not defined as Specified above).

- 12.12 At the Council Meeting on the 20<sup>th</sup> July, 2016, Council agreed to supplement our existing investment strategy by approving lending to organisations upon which we would undertake appropriate due diligence **and** put in place appropriate security arrangements. This could result in the Council being able to achieve better investment returns at an acceptable level of risk and to secure base budget savings over the short to medium term to protect frontline services.

- 12.13 Such transactions are termed “Non Specified Investments”. These are investments that do not meet all the criteria of “Specified Investments”. The criteria for Specified Investments are:

- The investment is denominated in sterling
- It is not long term
- It is not capital expenditure
- It is of high credit quality

- 12.14 Investment decisions in these “Non Specified Investments” will be subject to S151 officer determination, following appropriate due diligence and subject to appropriate and acceptable security arrangements being put in place as part of a commercial agreement.

- 12.15 It is proposed that a maximum exposure for this type of investment would remain set at £10M with a maximum maturity limit of 10 years.

- 12.16 Non specified investments could also include the Council’s own banker if it fails to meet the high credit criteria. In all instances balances are minimised by transferring monies to the DMO but there is a possibility that not all sums can be transferred. For example the DMO has a minimum deal size of £1m and deposits are on occasion transferred into the Council’s bank account after the deadline for daily trading / cash transfer. In such circumstances the Council’s exposure is limited to overnight.

- 12.17 The Council will not invest in any other non-specified investment.

## **12.18 Local Authority Mortgage Scheme**

- 12.19 As approved by Council on 4<sup>th</sup> July 2012, during September 2012, the Council launched the Local Authority Mortgage Scheme which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The Bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.
- 12.20 This is not strictly an investment – its primary purpose is to support first time buyers, stimulate the housing market and any beneficial wider economic regeneration which goes with it. The deposit is classed as a service investment rather than a treasury management investment and is therefore outside of the Specified / Non Specified categories.
- 12.21 Notwithstanding this, it is a deviation from the Council's normal treasury management operations. It will require a deposit to be placed with one or more institutions for a fixed period of 5 years. Clearly this exposes the Council to an element of Counterparty risk which is monitored by officers.

## 13.0 Risk Benchmarking

- 13.1 In accordance with the WG guidance (revised 2009), this Investment Strategy sets out the Council's policies for giving priority to firstly, the security of investments, secondly liquidity, and thirdly yield. It sets out the Council's criteria for choosing investment counterparties and limiting the exposure of risk of loss.
- 13.2 The revised codes and statutory guidance require the consideration, approval and monitoring of security and liquidity benchmarks. Yield benchmarks are currently widely used and less subjective than those relating to security and liquidity.
- 13.3 The benchmarks for security, liquidity and yield are targets, not limits and as such, may be breached from time to time. The purpose of the benchmark is to monitor trends and act as early warning signals. Actual activity levels will be reported in the mid year and annual reports.

### 13.4 Security

- 13.5 Security had previously been evidenced solely by the application of minimum credit criteria to investment counterparties, through credit ratings supplied by one of the three rating agencies, Fitch, Moody's and/or Standard & Poor's. The revised Codes and regulations require the extension of security monitoring by applying historic default trends to our own investment portfolio.
- 13.6 The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is 0.00% historic risk of default when compared to the whole portfolio. This reaffirms the fact that the Council places security above yield.

### 13.7 Liquidity

- 13.8 This is defined as having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities. The Council maintains a bank overdraft facility of £5m.
- 13.9 It is recommended that the Council sets limits for
- Liquid short term deposits available with a week's notice.
  - Weighted Average Life benchmark and maximum. The shorter the weighted average life of the portfolio implies less risk.

As we are maintaining low levels of cash to minimise credit risk, the setting of such targets / limits is not appropriate.

13.10 Any investment for greater than 365 days will be made with a prudent approach to cashflow requirements and in accordance with above limits.

13.11 The minimum amount to be held during 2017/18 in investments less than 365 days is the lower of

- £20m; or,
- the total value of the Council's investment portfolio.

13.12 Yield

13.13 The benchmark used is 7 day LIBID. At the moment, as our operating strategy is to only invest in the Debt Management Office or other public bodies, it is unlikely we will meet this target.

#### **14.0 Forecast for Investment Returns**

14.1 Traditionally, investments which would have been invested longer would secure better returns, however uncertainty over counterparty creditworthiness suggests short dated investments in higher credit quality establishments will provide better security. The Council will continue to favour security above return.

14.2 Expectations on shorter-term interest rates, on which investment decisions are based, show the current 0.25% Bank Rate continuing into the future, with a low possibility of a reduction in the Rate. Our projected interest receipts will be prudent, reflecting our low risk strategy.

## 15.0 **PRUDENTIAL CODE LIMITS FOR 2017/18**

- 15.1 There is a statutory duty under the Local Government Act 2003 for the Council to determine and keep under review how much it can afford to borrow. The Council must have due regard to the **Prudential Code** when setting its affordable borrowing limit ("Authorised Limit"). This requires the Council to ensure that total capital investment and borrowing remains affordable, sustainable and prudent.
- 15.2 To comply with both the Prudential Code and Treasury Management Code, the Council has to determine and set Prudential Indicators in relation to capital expenditure, external debt and treasury management activities. The purpose of the indicators is to provide a framework for Capital Expenditure decision making.
- 15.3 To comply with the Codes every Council is required to agree a set of Prudential indicators prior to the start of the financial year. These indicators must be prepared by the Chief Finance Officer and presented to Council, as part of the budget setting process. The indicators cover a three year period and must be monitored during the year.
- 15.4 The indicators are purely for internal use by the Council and are not intended for use as comparators (i.e. between Councils) nor should they be viewed individually. The real value will arise as a result of monitoring the movement in indicators over time.
- 15.5 Capital Expenditure is predominantly funded by Welsh Government support, capital grants and capital receipts. The remaining balance of expenditure will form a borrowing need. General capital funding from the Welsh Government takes the form of General Capital Grant plus "supported borrowing". Any amounts of capital expenditure above these limits will be classed as unsupported and will have an impact on the Council Tax (unless extra borrowing costs are funded through existing budgets).
- 15.6 The following indicators are required (by the Prudential Code) to be approved:
  - Capital Expenditure
  - Capital Financing Requirement
  - External Debt (Gross)
  - Authorised Limit
  - Operational Boundary
  - Ratio of Financing Costs to Net Revenue Stream
  - Incremental Impact of capital investment decisions on Band D Council Tax
- 15.7 The following indicators are required (by the Treasury Management Code) to be approved:
  - Adoption of the CIPFA Code of Practice on Treasury Management



- Interest Rate Exposure
- Debt Maturity Profile
- Funds invested for more than one year

## 16.0 Capital Expenditure and the Capital Financing Requirement

- 16.1 The Capital Expenditure plans of the Council will be financed through various sources such as capital receipts, grants, other contributions. The remaining element which cannot be immediately financed from resources will constitute our borrowing requirement. The estimated level of available capital resources is provided in summary as the Capital Expenditure Indicators below.

### Indicator : Capital Expenditure

	2016/17 Projected Outturn £M	2017/18 Estimate £M	2018/19 Estimate £M	2019/20 Estimate £M
Supported spend	75.008	74.269	29.376	22.877
Unsupported spend	20.762	32.976	13.003	0
Total spend	95.770	107.245	42.379	22.877
Financed by:-				
Borrowing	27.703	39.959	19.986	6.983
Other Capital Resources (e.g. Grants, Capital Receipts)	68.067	67.286	22.393	15.894

- 16.2 The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. The CFR is capital expenditure that has not yet been paid for from either revenue or capital resources.
- 16.3 The expected movement in the CFR over the next three years is dependent on the level of supported and unsupported capital expenditure and decisions taken during the budgeting cycle.
- 16.4 The unsupported element of borrowing relates to the capital expenditure freedom allowed under the Prudential Code. The Prudential Code anticipates that these freedoms would enable Councils to enter into projects such as "spend to save" schemes or decisions to allocate additional resource from revenue to capital, to enable service enhancements. Members have already shown their willingness to use this option for schemes such as investment in schools.
- 16.5 The main factor limiting the Council's ability to undertake unsupported capital expenditure is whether the revenue resource is available to support in full the implications of capital expenditure, i.e. both borrowing costs and

running costs. In other words, can the Council afford the implications of the unsupported capital expenditure?

- 16.6 The Council's expectations for the CFR in the next three years is shown below.

**Indicator : Capital Financing Requirement (CFR)**

	2016/17 31/03/17 Projected Outturn £M	2017/18 31/03/18 Estimate £M	2018/19 31/03/19 Estimate £M	2019/20 31/03/20 Estimate £M
CFR	407.884	435.926	443.419	437.073
Net movement in CFR		28.042	7.493	(6.346)

- 16.7 A key risk is that the level of Welsh Government support has been estimated and is, therefore, subject to change. Similarly, some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over this time. Officers will continue to monitor the totality of capital resources and will report back to Members if further action is required.

- 16.8 The expected external debt for each year is as detailed below.

**Indicator : External Debt**

	2016/17 31/03/17 Projected Outturn £M	2017/18 31/03/18 Estimate £M	2018/19 31/03/19 Estimate £M	2019/20 31/03/20 Estimate £M
Borrowing	244.870	314.725	363.579	391.934
Other long term liabilities	0.836	0.836	0.836	0.836
Total External Debt 31 <sup>st</sup> March	245.706	315.561	364.415	392.770
Net movement in External Debt		69.855	48.854	28.355

- 16.9 Long Term Liabilities include the Council's future finance lease payments. It previously included the Council's obligation under the PFI scheme but this liability has been replaced by external borrowing.

## 17.0 Limits to Borrowing Activity

- 17.1 The first key control over the Council's activity is to ensure that, over the medium term, borrowing will only be for a capital purpose. The Council needs to ensure that external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimate of the additional capital financing requirement for the next three financial years. This allows some flexibility within a three-year period to deliver an effective treasury management strategy.

### **Borrowing Activity (Gross Borrowing)**

	2016/17 31/03/17 Projected Outturn £M	2017/18 31/03/18 Estimate £M	2018/19 31/03/19 Estimate £M	2019/20 31/03/20 Estimate £M
Gross Borrowing	245.706	315.561	364.415	392.770
Capital Financing Requirement	407.884	435.926	443.419	437.073

- 17.2 As the above shows, gross borrowing is below the relevant CFR for current and future years. This is termed "underborrowing". This view takes into account current commitments, existing plans, and the proposals in the budget report. Again, this indicator will be monitored and revised at Council, if necessary, during the three-year period.
- 17.3 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set, monitored and revised by Members. It reflects the maximum level of borrowing to fund existing capital commitments, which could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some added headroom for unexpected movements. In the table at para 17.4 the figures for projected outturn for 2016/17 represent the total estimated debt.
- 17.4 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Council's plans, or those of a specific Council. The government has not yet exercised this control.

**Indicator : The Authorised Limit**

	2016/17 31/03/17 Projected Outturn £M	2017/18 31/03/18 Estimate £M	2018/19 31/03/19 Estimate £M	2019/20 31/03/20 Estimate £M
Gross Borrowing Limit	244.870	438.000	448.000	438.000
Other long term liabilities	0.836	2.000	2.000	2.000
Authorised Limit	245.706	440.000	450.000	440.000

- 17.5 The Operational Boundary is based on the probable external debt during the course of the year; actual borrowing could vary around this boundary, for short times, during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

**Indicator : The Operational Boundary**

	2016/17 31/03/17 Projected Outturn £M	2017/18 31/03/18 Estimate £M	2018/19 31/03/19 Estimate £M	2019/20 31/03/20 Estimate £M
Gross Borrowing Limit	244.870	320.000	370.000	400.000
Other long term liabilities	0.836	1.000	1.000	1.000
Operational Boundary	245.706	321.000	371.000	401.000

**18.0 Affordability Prudential Indicators**

- 18.1 Previous sections have covered overall capital and control of borrowing indicators, but there is also a requirement to assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the overall Council finances.
- 18.2 The Ratio of Financing Costs to Net Revenue Stream identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the "net revenue stream". The net revenue stream for the General Fund is the amount collectable from Council Tax payers added to the Council's Rate Support Grant (RSG) and Non Domestic Rates (NDR). The key use of this indicator is to compare trends in the ratio of financing costs to the net revenue stream, over time.

**Indicator : Ratio of Financing Costs to Net Revenue Stream**

	2016/17 Comparator	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund	4.64%	4.84%	5.10%	5.23%

- 18.3 The Incremental Impact Indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the Council's existing commitments and current plans.
- 18.4 Capital Investment by its very nature has a knock-on effect into the General Fund Revenue Account. For example, capital investment in our infrastructure assets should result in a reduced revenue maintenance burden etc.

**Indicator : Incremental impact of capital investment decisions on the Band D Council Tax**

	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Annual Impact on Council Tax - Band D	£0.70	-£0.08	-£0.01
Annual Impact on Council Tax - Band A	£0.47	-£0.05	£0.00
Percentage Impact on Council Tax Band D	0.05%	-0.01%	0.00%

- 18.5 The first Treasury Management indicator is that the Council has adopted the CIPFA Treasury Management Code of Practice. This Council adopted the Code during March 2002. The Code has been fully revised in 2009 with minor changes in 2011. We continue to adopt the revised version.
- 18.6 The Code requires limits to be set for :
- I. Upper limits on variable rate exposure – this indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.
  - II. Upper limits on fixed rate exposure – similar to the above indicator this covers a maximum limit on fixed interest rates.

There may be occasion where markets are such that borrowing might be in the best financial interest of the Authority but will be outside of the fixed / variable limits. It is therefore proposed to grant the Section 151 Officer (or in his absence the Deputy Section 151 Officer) with delegated powers to exceed the fixed / variable limits, in the best financial interests of the

Authority only, and if utilised, that this be reported to the next available meeting of Council.

#### Indicator : Interest Rate Exposure

	2016/17 Projected Outturn	2016/17	2017/18	2018/19	2019/20
<b>Borrowing</b>					
Limits on fixed rates	80%	55%-100%	45%-100%	45%-100%	45%-100%
Limits on variable rates	20%	0%-45%	0%-55%	0%-55%	0%-55%
<b>Investments</b>					
Limits on fixed rates *	0%	0%-25%	0%-25%	0%-25%	0%-25%
Limits on variable rates	100%	75%-100%	75%-100%	75%-100%	75%-100%
<b>Net Borrowing</b>					
Limits on fixed rates	80%	55%-125%	45%-125%	45%-125%	45%-125%
Limits on variable rates	20%	-25%-45%	-25%-55%	-25%-55%	-25%-55%

\* Does not include non specified investments.

- 18.7 For monitoring interest rate exposure purposes, LOBO's are included as fixed rate debt. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

	£M	% of Debt Portfolio
LOBO limits	50	20

The amount of LOBO debt held in 2016/17 is £31m being 14% of our total debt portfolio. This internally set limit may be temporarily exceeded as a consequence of debt restructuring activities.

- 18.8 The maturity structure indicator sets gross limits to reduce the Council's exposure to large fixed rate sums falling due for refinancing annually.

The 2011 CIPFA Treasury Management Code has revised the maturity structure indicator guidance. As a result, LOBO loans are deemed to have a maturity date of the next call date.

**Indicator : Maturity Structure**

	2016/17 Projected Outturn	Upper Limit	Lower Limit
Under 12 months	32%	70%	0%
12 months to 2 years	0%	70%	0%
2 years to 5 years	0%	60%	0%
5 years to 10 years	0%	70%	0%
10 years to 20 years	1%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	65%	90%	0%
40 years to 50 years	2%	90%	0%

18.9 In order to maximise investment returns there may be opportunities for sums to be invested for longer than one year. This would only be undertaken with a prudent view of the primary considerations of security and liquidity.

18.10 The following indicator takes account of projected resources available for investment and cashflow forecasts.

**Indicator : Total principal funds invested for periods longer than 364 days**

Maximum principal sums invested over 1 year	£15M
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18.11 During 2016/17, a commercially agreed loan agreement was entered into with Trivallis for an amount of £5.125m over 10 years. This is treated as a non specified investment and is part of the Investment Strategy enabling lending to organisations, subject to S151 officer determination, following appropriate due diligence and subject to appropriate and acceptable security arrangements.

18.12 The LAMS investment (as referenced at paragraph 12.18) is deemed to be a service investment as opposed to a treasury investment. The 5 year period of the £1m deposit comes to an end in September 2017. Whilst the deposit will be returned in full, there is a potential liability as the Authority is still providing an indemnity for each individual mortgage taken.

## **19.0 THE MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT**

- 19.1 In accordance with legislative requirements applicable to local government (Local Government Act 2003), there is a requirement to charge an amount to revenue each year in respect of capital expenditure. This charge is known as the "Minimum Revenue Provision (MRP)".
- 19.2 The implementation of the Prudential Code in 2004 (and subsequent updates) provided greater flexibilities for Councils to borrow to fund capital projects over and above their previous level of capital approvals - referred to as prudential or unsupported borrowing.
- 19.3 In 2008, and to complement the flexibilities afforded by the Prudential Code, Welsh Government amended the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (the 'Regulations') to provide for a number of differing options for charging to revenue costs incurred in respect of Capital Expenditure. The regulations also required the approval by full Council of this MRP Policy Statement.
- 19.4 Supported Borrowing – The MRP on supported borrowing is written off on a straight line basis over 40 years, linked (broadly) to the lives of the Council's assets.
- 19.5 Unsupported Borrowing - The historic 4% MRP has been removed as an option for unsupported (Prudential) borrowing and replaced with 3 alternatives :
- Charge in equal instalments (or to match the benefits derived) over the life of the asset created (asset life must be applied for any expenditure capitalised under a Capitalisation Direction);
  - Annuity method; or
  - Charge in accordance with the depreciation of the asset.
- 19.6 It is my view that each of these methods might be appropriate depending on the type of asset being created / funded by Prudential borrowing. It is also feasible that an alternative method might be appropriate (for example, linked to a payback period) - this is also recognised in the relevant Welsh Government guidance. The Regulations also allow for the commencement of MRP to be in line with the asset being brought into use. Accordingly, I am of the view that a decision upon the relevant method to apply should be made as part of the option appraisal decision to proceed with any Prudential borrowing on a project by project basis.
- 19.7 Finance lease schemes - MRP is equivalent to the principal value of repayments as permitted by regulations.



## **20.0 CONCLUSIONS**

- 20.1 This report provides the Council's Treasury Management Strategy and Annual Investment Strategy for 2017/18, and details the Prudential Indicators for the 3 year period 2017/18 to 2019/20.
- 20.2 With regards to the Treasury Management Strategy, a cautious approach will continue to be followed. The Section 151 Officer (or in his absence the Deputy Section 151 Officer) will monitor the interest rate environment and adopt a pragmatic approach to any changing circumstances, in consultation with the Council's independent treasury advisors.
- 20.3 With regards to the Prudential Indicators, these will be monitored throughout the financial year with details reported to Members as part of the Council's quarterly performance reporting framework and scrutiny process.

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